90-103

Supreme Court, U.S.
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JOSEPH F. SPANIOL, JR.

No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

S. EZRA AUSTERN and ESTHER AUSTERN,

Petitioners,

—against—

THE CHICAGO BOARD OPTIONS EXCHANGE, INC.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Questions Presented

1. Whether it was error of the Court of Appeals to hold that the arbitration sponsored by the CHICAGO BOARD OPTIONS EXCHANGE INC. (CBOE) was contractually agreed upon, and that it was therefore entitled to immunity from damage liability.

2. Whether it was error of the Court of Appeals to hold that the CBOE was entitled to immunity notwithstanding the absence of jurisdiction of the arbitration panel to arbitrate.

3. Whether it was error of the Court of Appeals to expand immunity to include a commercial sponsor of arbitration on grounds of policy to encourage arbitration.

4. Whether it was error of the Court of Appeals to hold that the CBOE is entitled to immunity for wrongs committed in the administration of, and preliminary to, arbitration.

5. Whether it was error of the Court of Appeals to hold that the CBOE was entitled to immunity notwithstanding its deprivation to petitioners of due process.

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S. EZRA AUSTERN and ESTHER AUSTERN,

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Respondent

- -x

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners S. EZRA AUSTERN and ESTHER AUSTERN ask that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered on March 15, 1990.

Opinions Below

The opinion of the United States

Court of Appeals for the Second Circuit is reported in 892 Fed.2d 882, and is reproduced at pages A1-A10 of the appendix. The opinion of the United States District Court for the Southern District of New York is reported in 716 Fed.Sup. 121, and is reproduced at pages A11-A26 of the appendix. The opinion of the United States District Court for the Northern District of Illinois in Fried Trading Co. v. Austern is not reported officially. It is reproduced at pages A27-A36 of the appendix.

Jurisdiction

The judgment of the Court of Appeals was entered on March 15th, 1990. A timely petition for rehearing with suggestion for rehearing in banc was denied on April 27th, 1990. Jurisdiction

of this court is invoked under 28 U.S.C. Section 1254 (1).

Constitutional Provisions Involved

1. The 14th Amendment to the Constitution of the United States provides in relevant part:

> . . . nor shall any State deprive any person of life, liberty, or property, without due process of law. . .

2. Article 1, Section 2 of the Constitution of the State of Illinois provides:

> No person shall be deprived of life, liberty or property without due process of law nor be denied the equal protection of the laws.

Statement Of The Case

On September 1st, 1983, a limited partnership known as FRIED TRADING

COMPANY (FRIED), a member organization of the CBOE, was formed for the purpose of trading option contracts. Petitioner ESTHER AUSTERN was a limited partner therein. Her husband, Petitioner S. EZRA AUSTERN, by separate agreement was a consultant for the partnership. In February, 1984 a dispute arose between the parties as a result of a deficit in ESTHER AUSTERN's options trading account. Under the auspices of a Bais Din (religious court) in Bnei Brak, Israel, the parties came to an agreement under which the Austerns agreed to arbitrate before the CBOE in accordance with the rules of the CBOE. See Fried Trading Co. v. Austern, No.86C8223, N.D.Ill., Memorandum opinion dated May 19, 1989 by District Judge Charles P. Kocoras.(A27) Pursuant to this Bais Din agreement, the dispute was referred to the CBOE for

arbitration (Id., A30)*

On September 14, 1984 FRIED filed a petition for arbitration with the CBOE for monies allegedly due it from the Austerns. Appellants, who until November of 1986 were residents of Bnei Brak, Israel, answered the petition on November 26, 1984, and the CBOE accepted the matter for arbitration. The arbitration rules of the CBOE which govern the selection of arbitrators and other procedures, and which were incorporated by reference into the said agreement of the parties, required (1) that the panel be composed of five arbitrators, "at least the majority of whom shall not be

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* The footnote reference contained in Circuit Judge Meskill's Opinion to a factual finding of Judge Kocoras that appellant S. EZRA AUSTERN was bound by the terms of the limited partnership agreement is in error. Judge Kocoras found that the Austerns had agreed to arbitrate before the CBOE by virtue of the Bais Din agreement.

from the securities industry," and (2) that "Notice of the time and place for the initial hearing . . . be given at least eight (8) business days prior to the date fixed for the hearing by personal service, registered or certified mail to each of the parties." The CBOE also specifically agreed to attempt to accommodate the Austerns' schedule with a mutually convenient hearing date "due to the great distance Respondents will have to travel to attend a hearing." In September of 1986 the Austerns withdrew their appearance , answer and counter-claim in the CBOE arbitration after they learned that FRIED was a differently configured partnership from the FRIED TRADING COMPANY with which the Austerns had understood they would arbitrate. Nevertheless, on October 22 and 23, 1986, a panel of five arbitrators designated by

the CBOE conducted an ex parte hearing and issued an award of approximately $158,000 in favor of Fried. None of the arbitrators was from outside of the securities industry. Indeed all were fellow members of Fried in the CBOE. In further violation of the CBOE rules, no opportunity was provided to challenge any of the arbitrators. Despite attempts to provide petitioners' former attorneys with notice of the hearing, the Austerns never received any such notice from the CBOE. The hearing took place without petitioners' presence or knowledge. On October 29, 1986, FRIED commenced a proceeding in the United States District Court for the Northern District of Illinois to confirm the award pursuant to Section 9 of the Federal Arbitration Act, 9 U.S.C. Section 9. However, because the CBOE had failed to provide the Austerns

with adequate notice of the arbitration hearing, Judge Kocoras ratified the findings of Magistrate Balog, to whom the matter had been assigned, and denied Fried's petition for confirmation. (A44-A46)

On January 20, 1989, the Austerns filed suit against the CBOE in the United States District Court for the Southern District of New York to recover damages for mental anguish and the expense of defending against Fried's unsuccessful confirmation action. In a nine-count complaint* the Austerns claimed that the CBOE's empaneling and scheduling of the arbitration proceedings in violation of the agreement of the parties, the CBOE rules and the CBOE's specific determinations caused them injury in the amount

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* Petitioners' amended complaint is reproduced at page A39 of the appendix.

of $612,000. The Austerns also claimed that the CBOE's failure to provide them with adequate notice of the arbitration hearing "amounted to callous and reckless misconduct, negligence, carelessness and wanton disregard of common decency and fair play", (A48) and violated their right to procedural due process under the Fourteenth Amendment to the United States Constitution and Article I, Section 2 of the Illinois Constitution. (A49)

On May 19th, 1989, while such suit was pending in the Southern District of New York, Judge Kocoras found in the Northern District of Illinois that the Austerns had agreed to submit their dispute to CBOE arbitration and that the CBOE had general jurisdiction to resolve same. (A27)

In an opinion and order dated July

31, 1989, Judge Cedarbaum dismissed the Austerns' complaint pursuant to Fed. R. Civ. P. 12(b)(6). The District Court ruled that the CBOE, as the organization sponsoring arbitration, was shielded from civil liability under the doctrine of arbitral immunity. 716 F.Supp. at 123-124. (A11) In the alternative, the court ruled that Section 10 of the Federal Arbitration Act "provides the exclusive remedy for challenging conduct that taints an arbitration award." (A24) Finally, the court found that the conduct of the CBOE did not constitute state action for either federal or state due process purposes. (A26)

On appeal to the United States Circuit Court of Appeals for the Second Circuit, the judgment of the District Court was affirmed. Austern v. CBOE Inc., 898 Fed.2d 882 (A1) Appellants

herein seek a Writ of Certiorari to review the said judgment of the Court of Appeals.

Reasons for Granting the Writ

I. THE ASSUMPTION IMPLICIT IN THE DETERMINATION OF THE COURT OF APPEALS THAT THE ARBITRATION WAS CONTRACTUALLY AGREED UPON IS ERRONEOUS AND INCORRECT.

Judge Charles P. Kocoras of the United States District Court for the Northern District of Illinois, in FRIED TRADING CO. v. AUSTERN, No. 86C 8223 (N.D.Ill, May 19, 1989), found that both the underlying partnership agreement and the Bais Din agreement had provided that arbitration be in accordance with the rules of the CBOE. (A29) These rules were incorporated by reference into the agreement of the parties and became part and parcel of such agreement. One of

such rules provided that a majority of the arbitrators be from outside the securities industry.(A51) In addition, the CBOE had specifically determined on August 16th, 1985 that a majority of the arbitration panel would not be from the securities industry. (A51)

In fact, all of the arbitrators were professional market-makers from the securities industry, and all were fellow members of Fried in the CBOE. (A51) In further breach of CBOE rules, no opportunity to challenge the arbitrators was given. (A57,A58) The designation by the CBOE of this panel and its purported exercise of arbitral power were thus flagrant violations of the said agreement of the parties and the CBOE's own prior determination. Accordingly the arbitration conducted by such panel on October 22nd and 23rd, 1986 was not

contractually agreed upon arbitration. The assumption by the Court of Appeals, in affirming the decision of the District Court - that such arbitration was contractually agreed upon - is thus clearly erroneous and incorrect.

The Court of Appeals stated on page 9 of its opinion that "the acts complained of here - defective notice and improper selection of the arbitration panel - were . . . performed directly in connection with the CBOE's management of contractually agreed upon arbitration. . ." (A10) This is a patent contradiction in terms, because such lack of proper notice and improper selection, being violative of the agreement of the parties, ipso facto rendered the arbitration something not contractually agreed upon.

The jurisdictional basis of arbitration is agreement of the disputing

parties to arbitrate. Arbitration is a matter of contract. If there was agreement herein generally to submit to CBOE arbitration, there was no agreement herein to submit to a panel of arbitrators made up exclusively of market makers from the securities industry. A party cannot be required to submit to arbitration where he has not agreed to so submit. Atkinson v. Sinclair Refining Co., 370 U.S.238 (1962).

As aptly suggested by the court in Baar v. Tigerman, 140 Cal.App.3d 979, there is a marked distinction in origin and nature between judge and arbitrator. A judge derives his jurisdiction from the sovereign state and statute; an arbitrator's authority and jurisdiction are strictly limited by and co-extensive with the particular agreement of the parties. Judicial proceedings are public

in nature; arbitrations are private. The judge must follow the law; the arbitrator may disregard it. The judge is bound by rules of evidence; the arbitrator is not. The judge is bound by the doctrine of stare decisis and precedent; arbitrators are not. Judges are subject to appellate review and appeal; arbitration awards are generally final.

It is self-evident that arbitration does not contain the built-in protective devices, including the foregoing checks and balances, that a judicial proceeding has. For these reasons it is vital to ensure that the submission to arbitration be in all respects voluntary, and that each and every condition precedent to the voluntary agreement entered into be respected and upheld.

In Corey v. New York Stock Exchange, 69 F.2d 1205, cited by the Court of

Appeals (and which appears to be the only appellate precedent in the United States extending immunity to a commercial sponsor of arbitration)*, the Sixth Circuit stressed at least seven times (pp.1209-1211) the condition vital to the grant of immunity, viz., voluntary submission to arbitration and the contractual agreement of the parties.

The agreement to arbitrate in accordance with the CBOE rules was a condition precedent to the power of the arbitration panel to act, and indeed was their very raison d'etre. It follows that no immunity can attach to the arbitrator in the absence of compliance with such agreement. If the foundation

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* The Court of Appeals indicated dictum support for this theory in the Ninth Circuit (A9). However, there is no reference in point to any Ninth Circuit decision.

upon which arbitration rests, to wit, the agreement to arbitrate, is in the first instance absent or is violated, as it was herein, by the creation of a counterfeit arbitration panel, its determinations and rulings perforce fall. Any arbitral immunity incident to the arbitration process must fall with it.

II. THE ARBITRATION PANEL WHICH CONDUCTED THE ARBITRATION WAS TOTALLY LACKING IN JURISDICTION, AND THE CBOE, ITS SPONSOR AND CREATOR, IS ACCORDINGLY NOT ENTITLED TO IMMUNITY.

Where there is a total absence of jurisdiction, a judge, and by extension, an arbitrator, is not entitled to immunity. See Bradley v. Fisher, 80 U.S. 335, where the court said at page 351-352:

> Where there is clearly no jurisdiction over the subject-matter any authority exercised is a usurped authority. . .
>
> In the case at bar the arbitration

panel, consisting exclusively of members of the securities industry and selected in violation of the agreement of the parties, was a counterfeit panel that had absolutely no standing or jurisdiction. While the U. S. District Court of Illinois found that there was general agreement to submit to CBOE arbitration and that the CBOE had general jurisdiction to arbitrate, (Fried Trading Co. v. Austern A27, A35), the actual arbitration (which resulted in an unconfirmed award in favor of Fried) was conducted in the total absence of jurisdiction. Any grant of immunity to the arbitrators themselves would thus conflict with the dictum of the Supreme Court in Bradley v. Fisher, supra.

Since the arbitrators themselves, by virtue of such total absence of jurisdiction, were not entitled to immunity,

the sponsoring organization which had engineered the arbitration by its wrongful selection of a panel of arbitrators exclusively from the securities industry, should, a fortiori, not be entitled to immunity. The Court of Appeals has correctly pointed out the principle established by the Supreme Court in Forrester v. White, 108 S.Ct. 538, 544, that "immunity is justified and defined by the functions it protects and serves, not by the person to whom it attaches." But in the instant case there was no judicial or quasi-judicial or arbitral function to be protected and served. Protecting and serving a counterfeit panel totally lacking in jurisdiction is not a function to be protected. See Bradley v. Fisher, supra. Nor was the CBOE a "person to whom [immunity] attaches," since under the doctrine of

Forrester - the doctrine of functional comparability - its sponsorship alone could not ipso facto confer such immunity upon it.

III. THE EXPANSION OF IMMUNITY SO AS TO SHIELD THE SPONSOR IN THE CIRCUMSTANCES HEREIN DOES NOT SERVE THE POLICY TO ENCOURAGE ARBITRATION.

A. THE PURPOSE OF IMMUNITY IS TO PROTECT THE DECISION-MAKER IN THE EXERCISE OF HIS JUDICIAL OR QUASI-JUDICIAL FUNCTION.

The Circuit Court correctly pointed out that the purpose of arbitral immunity is to shield judges "from damages liability for actions taken in the exercise of their judicial functions" (A6). Quoting from Corey, supra, the court went on to say that "arbitral immunity is essential to protect the decision-maker from undue influence and protect the decision-making process . . ." (Underlining supplied) (A8)

But the acts herein complained of

were not judicial acts and were not made in the decision-making process. They were made in a stage preliminary to and prior to actual arbitration. They were made administratively in the implementation of administrative decisions long before actual arbitration. The grant of immunity for such acts does nothing to serve and protect the arbitrator in his decision-making capacity and his need for independent judgment. Rather it serves to protect, promote and give license to behind-the-scene corruption and negligence and all manner of wrongdoing on the part of the staff of sponsoring organizations. If they are shielded from liability arising out of breach of their own rules and their own determinations, what is the point of having such rules and determinations? The congressional intent expressed in the Federal Arbitra-

tion Act to encourage and promote arbitration agreements is not served by allowing a sponsor to scorn and violate the sanctity of such an agreement which incorporates by reference those same rules. To shield the sponsor from all liability on a theory of absolute immunity makes a mockery out of both the rules and the arbitration agreement.

In any event, while the policy to encourage arbitration is understandable, there must be a reasonable balance struck between the desire to promote arbitration and the age-old and primary policy of the law to redress wrong. Surely an establishment sponsoring arbitration should be bound to at least a minimum standard of care and conduct. Far from encouraging arbitration, the blind and open-ended extension of absolute immunity to a sponsor for any and all activity

associated with the arbitration process opens the door to such sponsor to commit with carte blanche unlimited wrongs, flout its own rules and decisions, and wreak mischief and injury to the innocent with impunity. Far from encouraging the use of arbitration, it has the effect of discouraging the utilization of the arbitration process and defeats the same policy that immunity was intended to serve.

B. THE PRINCIPLE UNDERLYING COREY V. NEW YORK STOCK EXCHANGE IS NOT APPLICABLE HEREIN.

The Circuit Court in affirming the decision of the U. S. District Court dismissing the complaint based its determination on the theory of Corey, supra. (A9) Such theory is that extension of immunity to the sponsor is necessary to prevent the shifting of

responsibility from the arbitrators to the sponsor and thus render immunity "illusionary". Corey, supra, p.1211. By the same token, it follows logically, as the court in Baar, supra, at page 839, pointed out, "when immunity does not attach to the arbitrator, it cannot protect the sponsor."

While the Corey theory is valid and applicable where an attempt is made to hold the sponsor liable vicariously for wrongs committed by the arbitrators, as in Corey, or where such wrongs are imputable to the sponsor - (e.g., on the principle of master-servant) - it is not valid and makes no sense logically where the wrong of the sponsor is committed independently by it and not attributable to it by imputation. In the instant case there was no attempt to shift liability from the arbitrators to the sponsor.

While the assumption of arbitral power by the arbitrators was wrongful, the complaint herein was directed not against them but against the CBOE, the agency which had in the first instance engineered and set in motion the spurious arbitration panel and its proceedings, including the invalid award in favor of FRIED. Petitioners were aggrieved by the independent wrongs of the CBOE in its administrative role. If indeed the arbitrators were entitled to immunity, such entitlement was surely not rendered illusory by proceeding against the CBOE for acts in which the arbitrators had no role, to wit, the failure to give notice of the arbitration and the wrongful selection of the arbitration panel.

Corey is otherwise clearly distinguishable. Corey himself initiated the arbitration proceeding. He selected

the forum and executed a submission agreement. He never contested jurisdiction of the arbitration panel. In the case at bar there was a total lack of notice to the Austerns, who never signed a submission agreement. Facts alleged in the complaint showed a total absence of jurisdiction. Corey complained of decision-making acts of both the arbitrator and the director of arbitration. The acts complained of herein were ministerial acts of the sponsor only. In Corey there was no evidence of willful and deliberate misconduct. Here there was. Corey did not avail himself of the appeal provisions of the Federal Arbitration Act. He sought instead to circumvent the arbitrators' immunity by attacking the award collaterally. In the case at bar proceedings under such act resulted in a denial of confirmation of the

arbitration award. There was no award to attack.

C. THE COURT OF APPEALS BASED ITS DETERMINATION ON THE ERRONEOUS ASSUMPTION THAT THE CBOE WAS GUILTY OF MERE NEGLIGENCE.

Appellants' amended complaint, accepted as true for the purpose of this appeal, alleges the following misconduct by the CBOE:

a) Callous and reckless misconduct and wanton disregard of common decency and fair play in failing to give appellants notice of the arbitration hearing. (A48)

b) Flouting its own rules and determination requiring that a majority of the arbitration panel be from outside the securities industry, and packing the panel with arbitrators exclusively from such industry. (A44, A51, A58)

c) Denial to petitioners of the opportunity under the CBOE rules to challenge the arbitrators selected. (A57, A58)

d) Disregarding its own determination to accommodate petitioners' schedule with a convenient hearing date, due to the great distance they had to travel. (A52, A53)

The Circuit Court's characterization of this conduct as mere negligence is a gross understatement. If the tenor and language of the complaint are to be given effect, then the CBOE's activity herein was a calculated, deliberate course of conduct intended to do mischief and harm to petitioners.

D. THE COURT OF APPEALS ERRONEOUSLY EQUATED SPONSOR WITH ARBITRATORS.

The determination of the Court of

Appeals extending immunity to the sponsoring organization, in effect, erroneously equated such sponsor with the arbitrators. Overlooked in such determination are significant distinctions between the two:

a) Arbitrators, like judges and court clerks, take oaths of office. Sponsors and their officials do not.

b) The arbitrator's action is subject to review and confirmation by a court of competent jurisdiction. The sponsor's conduct is not.

c) The arbitrator usually acts in concert with other co-arbitrators subject to the scrutiny, examination, cross-examination and built-in checks and balances of the adversarial system. The sponsor acts alone, responsible to nobody but itself and its membership, from whose ranks both the adverse party and arbi-

trators may come, as indeed they all did in the case at bar.

IV. THE CBOE IS NOT ENTITLED TO IMMUNITY FOR WRONGS COMMITTED IN THE ADMINISTRATION OF, AND PRELIMINARY TO, ARBITRATION.

In Forrester v. White, supra, the Supreme Court said at page 544:

> Difficulties have arisen primarily in attempting to draw the line between truly judicial acts, for which immunity is appropriate, and acts that simply happen to have been done by judges . . . The decided cases, however, suggest an intelligible distinction between judicial acts and the administrative, legislative, or executive functions that judges may on occasion be assigned by law to perform . . .

All of the acts complained of herein were committed by the CBOE in its administrative role. None required the exercise of judgment or discretion. Any child with a sixth grade mentality was capable of addressing and posting a

letter in accordance with the CBOE rules notifying the Austerns of the time and place of the hearing. A robot could have been used to select at random three members of the panel from outside the securities industry. Immunity does not extend to a sponsor of arbitration for its administrative actions, Baar v. Tigerman, 189 Cal.Rptr.834 (1983)

The function that immunity is intended to protect and serve, as envisaged by the Supreme Court in Forrester, is the decision-making process, judicial or arbitral. The acts of the CBOE complained of herein were strictly procedural, having nothing to do with the decision-making process. They were committed in a stage preliminary to and distant from the adjudicative phase of the arbitraiton. The expansion of the scope of immunity to include such acts,

irrespective of their culpability or their ministerial nature, is a labored, forced and uncalled-for stretch of the doctrine of Forrester, which clearly delineates an administrative function as something beyond the scope of immunity. The court in Forrester pointed out that "Administrative decisions, even though they may be essential to the very functioning of the courts, have not similarly been regarded as judicial acts." (p.544)

In Forrester the Supreme Court denied immunity to a judge with regard to his decision to discharge a probation officer. Herein the CBOE's acts complained of never rose to the level and dignity of decisions. They were ministerial acts performed in the implementation of decisions already made, and were accordingly even less worthy of immunity.

In any event, if the principle of Forrester is to deny protection to the administrative act of the judge, then surely the sponsor of arbitration, which is the administrative arm of the arbitrator, is entitled to no greater protection. The matter is not, as suggested by the Court of Appeals, one of semantics. The distinction between purely administrative acts and the legitimate function that immunity is intended to serve is real and substantial.

V. FAILURE TO GIVE PETITIONERS NOTICE OF THE ARBITRATION HEARING AMOUNTED TO A DEPRIVATION OF DUE PROCESS.

The Supreme Court has noted in Mullane v. Central Hanover Trust Co., 339 U.S. 306, 314:

> An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all circumstances, to apprise interested parties of the pendency

> of the action and afford them an opportunity to present their objections.

Compounding the fatal jurisdiction defect of the arbitration panel herein were the total lack of notice to petitioners of the arbitration hearing and the conduct of a hearing without their knowledge or presence. A more flagrant case of usurpation of authority is difficult to imagine.

The Circuit Court has utterly failed to address the legal consequences arising out of such absence of notice, which clearly amounted to a deprivation of due process. Whether such deprivation was a constitutional deprivation or simply a deprivation of due process in the generic sense of the term, it was nevertheless a grievous wrong which did not merit protection by the doctrine of immunity. See Butz v. Economou 438 U. S. 478, 507,

where the court said:

> . . . we see no substantial basis for holding . . . that executive officers generally may with impunity discharge their duties in a way that is known to them to violate the United States Constitution or in a manner that they should know transgresses a clearly established constitutional rule.

In purporting to give petitioners notice of the arbitration, the CBOE was performing a service akin to that of an independent process server, and was no more entitled to immunity in failing to give such notice than the process server would be entitled to for making a phony service. Again the function rather than the actor determines the grant of immunity. Forrester v. White, supra.

It follows logically that if the bastard arbitration panel lacked immunity by virtue of its illegitimacy, then the creator of such panel - the CBOE, the

wrongdoer which had engineered such illegitimacy and had deprived the petitioners of due process - should enjoy no similar protection.

Assuming arguendo that some element of state action is necessary to invoke the constitutional requirement of due process, petitioners at the very least were entitled to demonstrate same evidentially. This right was preempted by the court's summary dismissal of the complaint. Having expressly accepted for purposes of the appeal the allegations of the complaint, it was error of the Court of Appeals to disregard totally such allegations pertaining to the violation of due process and to affirm the action of the District Court so dismissing the complaint.

Conclusion

For the above reasons a writ of certiorari should issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit.

Dated: Brooklyn, New York
July 1, 1990

Respectfully submitted,

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APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 520—August Term, 1989

(Argued January 9, 1990 Decided March 15, 1990)

Docket No. 89-7792

S. EZRA AUSTERN and ESTHER AUSTERN,

Plaintiffs-Appellants,

—v.—

THE CHICAGO BOARD OPTIONS EXCHANGE, INC.,

Defendant-Appellee.

Before:

MESKILL and NEWMAN, *Circuit Judges*,
and POLLACK,* *District Judge*.

Appeal from a judgment entered in the United States District Court for the Southern District of New York, Cedarbaum, *J.*, dismissing plaintiffs-appellants' com-

* Hon. Milton Pollack, United States District Judge for the Southern District of New York, sitting by designation.

plaint pursuant to Fed. R. Civ. P. 12(b)(6) on the ground of arbitral immunity.

Affirmed.

S. EZRA AUSTERN, Brooklyn, NY, *for Appellants*.

REID L. ASHINOFF, New York City (Mark S. Pomerantz, Ashinoff, Ross & Korff, New York City, of counsel), *for Appellee*.

MESKILL, *Circuit Judge*:

The central question presented by this appeal is whether a commercial organization sponsoring a contractually agreed upon arbitration is immune from civil liability for improperly noticing the arbitration hearing and improperly selecting the arbitration panel.

Plaintiffs S. Ezra and Esther Austern (the Austerns) appeal from a judgment entered in the United States District Court for the Southern District of New York, Cedarbaum, *J.*, dismissing their complaint against defendant Chicago Board Options Exchange, Inc. (CBOE) pursuant to Fed. R. Civ. P. 12(b)(6) on the ground of arbitral immunity. The complaint sought compensation for expenses incurred in defending an arbitration confirmation proceeding in the United States District Court for the Northern District of Illinois, Kocoras, *J.* On appeal, the Austerns contend principally

that the conduct of the CBOE, the commercial organization that sponsored the arbitration, fell outside the scope of arbitral immunity.

The judgment is affirmed.

BACKGROUND

For purposes of this appeal, we accept, as we must, the factual allegations contained in appellants' complaint as true. *See, e.g., Corcoran* v. *American Plan Corp.*, 886 F.2d 16, 17 (2d Cir. 1989); *Tucker* v. *Bay Shore Union Free School Dist.*, 873 F.2d 563, 563 (2d Cir. 1989); *Bankers Trust Co.* v. *Rhoades*, 859 F.2d 1096, 1098 (2d Cir. 1988), *cert. denied*, 109 S.Ct. 1643 (1989). The facts of this case are thoroughly set forth in the district court's opinion, reported at 716 F.Supp. 121 (S.D.N.Y. 1989). Therefore, we shall briefly recount only those facts relevant to the present appeal.

Fried Trading Company (Fried), an options trading partnership, is a member organization of the CBOE. Pursuant to an arbitration clause in the options trading partnership agreement between Fried and the Austerns, Fried, on September 14, 1984, filed a petition for arbitration with the CBOE for monies due under the agreement.[1] The Austerns, who until November 1986 were

1 Although S. Ezra Austern was not a signatory to the partnership agreement, Judge Cedarbaum properly accepted the factual finding of Judge Kocoras in *Fried Trading Co.* v. *Austern*, No. 86 C 8223 (N.D. Ill. Dec. 1, 1988) (LEXIS, Genfed library, Dist file; WESTLAW, Federal Dct Database)—the underlying confirmation proceeding that was incorporated into the pleadings by attachment and reference thereto, *see* Fed. R. Civ. P. 10(c)—that both Esther, who was a signatory, and Ezra were bound by the terms of that agreement. *See Decker* v. *Massey-Ferguson, Ltd.*, 681 F.2d 111, 113 (2d Cir. 1982). *See generally* 5 C. Wright & A. Miller, *Federal Practice and Procedure* § 1327 (1969).

residents of Bnei Brak, Israel, answered the petition on November 26, 1984 and soon thereafter the CBOE accepted the matter for arbitration.

The arbitration rules of the CBOE, which governed both the selection of the arbitration panel and the procedures to be followed, mandated that (1) the panel be composed of five arbitrators, "at least a majority of whom shall *not* be from the securities industry," and (2) "[n]otice of the time and place for the initial hearing . . . be given at least eight (8) business days prior to the date fixed for the hearing by personal service, registered or certified mail to each of the parties." The CBOE also agreed to attempt to accommodate the Austerns' schedule with a mutually convenient hearing date "due to the great distance Respondents [were required] to travel to attend [the] hearing."

In September 1986, the Austerns withdrew their appearance, answer and counterclaim. Nevertheless, on October 22 and 23, 1986, a panel of five arbitrators designated by the CBOE conducted an *ex parte* hearing and issued an award of approximately $158,000 in favor of Fried. None of the arbitrators was from outside of the securities industry and, despite attempts to provide appellants with notice of the hearing, the Austerns never received any such notice from the CBOE. The hearing apparently took place without either appellants' presence or knowledge.

Soon thereafter, on October 29, 1986, Fried commenced a proceeding in the United States District Court for the Northern District of Illinois to confirm the award pursuant to section 9 of the Federal Arbitration Act, 9 U.S.C. § 9. However, because the CBOE had failed to provide the Austerns with adequate notice of

the arbitration hearing, Judge Kocoras ratified the findings of Magistrate Balog, to whom that matter had been assigned, and denied Fried's petition for confirmation. *See Fried Trading Co.* v. *Austern*, No. 86 C 8223 (N.D. Ill. Dec. 1, 1988) (LEXIS, Genfed library, Dist file; WESTLAW, Federal Dct Database).[2]

On January 20, 1989, the Austerns filed suit in the United States District Court for the Southern District of New York seeking to recover damages for mental anguish and the expense of defending against Fried's unsuccessful confirmation action. In a nine count complaint the Austerns claimed that the CBOE's negligent empaneling and scheduling of the arbitration proceedings caused them injury in the amount of $612,000. The Austerns also claimed that the CBOE's failure to provide them with adequate notice of the arbitration hearing violated their right to procedural due process under the Fourteenth Amendment to the United States Constitution and Article I, Section 2 of the Illinois Constitution.

In an opinion and order dated July 31, 1989, Judge Cedarbaum dismissed the Austerns' complaint *in totus* pursuant to Fed. R. Civ. P. 12(b)(6). The district court ruled that the CBOE, as the organization sponsoring the arbitration, was shielded from civil liability under the doctrine of arbitral immunity. 716 F.Supp. at 123-24. In the alternative, the court ruled that section 10 of the Federal Arbitration Act "provides the exclusive remedy for challenging conduct that taints an arbitration award." *Id.* at 124. Finally, the court found that the conduct of the CBOE did not constitute state action for

2 At oral argument, the parties indicated that the CBOE had scheduled a second arbitration hearing for January 15, 1990.

either federal or state due process purposes. *Id.* at 125. This appeal followed.

DISCUSSION

On appeal, as in the district court, the Austerns contend principally that the acts of which they complain, "being of an administrative or ministerial nature, d[o] not merit [arbitral] immunity." We disagree and, consequently, affirm the dismissal of appellants' complaint.

A. *Standard of Review*

Dismissal for failure to state a claim pursuant to Fed. R. Civ. P. 12(b)(6) is a ruling of law subject to *de novo* review, *Leidholdt* v. *L.F.P. Inc.*, 860 F.2d 890, 893 (9th Cir.), *cert. denied*, 109 S.Ct. 1532 (1988); *Wells* v. *Walker*, 852 F.2d 368, 369-70 (8th Cir.), *cert. denied*, 109 S.Ct. 1121 (1988); *Dugan* v. *Brooks*, 818 F.2d 513, 516 (6th Cir. 1987), and will be upheld on appeal only if " 'it appears beyond doubt that the plaintiff[s] can prove no set of facts in support of [their] claim which would entitle [them] to relief,' " *Philips Business Sys., Inc.* v. *Executive Communications Sys., Inc.*, 744 F.2d 287, 290 (2d Cir. 1984) (quoting *Conley* v. *Gibson*, 355 U.S. 41, 45-46 (1957) (footnote omitted)).

B. *Arbitral Immunity*

Absolute immunity, "justified and defined by the *functions* it protects and serves, not by the person to whom it attaches," *Forrester* v. *White*, 484 U.S. 219, 227 (1988), has long shielded judges from damages liability for actions taken in the exercise of their judicial functions. *See Bradley* v. *Fisher*, 80 U.S. (13 Wall.) 335, 347 (1872); *see also Stump* v. *Sparkman*, 435 U.S. 349,

355-57 (1978); *Pierson* v. *Ray*, 386 U.S. 547, 553-55 (1967); *Heimbach* v. *Village of Lyons*, 597 F.2d 344, 347 (2d Cir. 1979). This comparatively sweeping form of immunity has also been extended to executive branch officials who perform either quasi-judicial functions, *see Butz* v. *Economou*, 438 U.S. 478, 513-14 (1978) (administrative law judge and various agency officials), or prosecutorial functions "intimately associated with the judicial phase of the criminal process," *Imbler* v. *Pachtman*, 424 U.S. 409, 430 (1976); *accord Rudow* v. *City of New York*, 822 F.2d 324, 327-30 (2d Cir. 1987); *Barr* v. *Abrams*, 810 F.2d 358, 360-62 (2d Cir. 1987); *Yaselli* v. *Goff*, 12 F.2d 396, 406 (2d Cir. 1926) (holding special assistant to the Attorney General of the United States absolutely immune from a civil action for malicious prosecution on principles of public policy), *aff'd*, 275 U.S. 503 (1927) (per curiam). As with judicial immunity, which "protect[s] the finality of judgments [by] discouraging inappropriate collateral attacks . . . [and] also protect[s] judicial independence by insulating judges from vexatious actions prosecuted by disgruntled litigants," *Forrester*, 484 U.S. at 225 (citing *Bradley*, 80 U.S. (13 Wall.) at 348), the scope of quasi-judicial immunity is defined not by the identity of the actor but by the nature of the function performed, namely freeing the adjudicative process and those involved therein from harassment or intimidation. *See Butz*, 438 U.S. at 512.

Based primarily on the "functional comparability" of the arbitrator's role in a contractually agreed upon arbitration proceeding to that of his judicial counterpart, the Courts of Appeals that have addressed the issue have uniformly immunized arbitrators from civil liability for all acts performed in their arbitral capacity. *See Wasyl, Inc.* v. *First Boston Corp.*, 813 F.2d 1579, 1582

(9th Cir. 1987); *Ozark Air Lines, Inc.* v. *National Mediation Board*, 797 F.2d 557, 564 (8th Cir. 1986); *Austin Municipal Securities, Inc.* v. *National Ass'n of Securities Dealers, Inc.*, 757 F.2d 676, 686-91 (5th Cir. 1985); *Corey* v. *New York Stock Exchange*, 691 F.2d 1205, 1208-11 (6th Cir. 1982); *Tamari* v. *Conrad*, 552 F.2d 778, 780 (7th Cir. 1977); *Cahn* v. *International Ladies' Garment Union*, 311 F.2d 113, 114-15 (3d Cir. 1962) (per curiam); *accord Calzarano* v. *Liebowitz*, 550 F.Supp. 1389, 1390-91 (S.D.N.Y. 1982). As the Sixth Circuit stated in *Corey*:

> The functional comparability of the arbitrators' decision-making process and judgments to those of judges and agency hearing examiners generates the same need for independent judgment, free from the threat of lawsuits. Immunity furthers this need. As with judicial and quasi-judicial immunity, arbitral immunity is essential to protect the decision-maker from undue influence and protect the decision-making process from reprisals by dissatisfied litigants.

691 F.2d at 1211.

We are persuaded by these policy concerns and agree that the nature of the function performed by arbitrators necessitates protection analogous to that traditionally accorded to judges. Furthermore, we note that "individuals . . . cannot be expected to volunteer to arbitrate disputes if they can be caught up in the struggle between the litigants and saddled with the burdens of defending a lawsuit." *Tamari*, 552 F.2d at 781. Accordingly, we hold that arbitrators in contractually agreed upon arbitration proceedings are absolutely immune from liability

in damages for all acts within the scope of the arbitral process.

The appellants, while acknowledging the existence of arbitral immunity, contend that the acts of which they complain—*i.e.*, the CBOE's improper notice and scheduling of the arbitration hearing and improper selection of five arbitrators from the securities industry—were ministerial in nature rather than part of the actual decision-making process and, as such, were outside the scope of arbitral immunity. We disagree.

At the threshold, we note, as have both the Sixth and Ninth Circuits, that

> [e]xtension of arbitral immunity to encompass boards [that] sponsor arbitration is a natural and necessary product of the policies underlying arbitral immunity; otherwise the immunity extended to arbitrators is illus[ory]. It would be of little value to the whole arbitral procedure to merely shift the liability to the sponsoring association.

Corey, 691 F.2d at 1211 (quoted in *Ozark Air Lines*, 797 F.2d at 564). The CBOE, as the commercial sponsoring organization, is therefore entitled to immunity for all functions that are integrally related to the arbitral process. Furthermore, semantically categorizing the challenged acts as "ministerial" or administrative, as opposed to "discretionary," in large part misses the mark, since the scope of arbitral immunity is "defined by the *functions* it protects and serves." *Forrester*, 484 U.S. at 227.

Contrary to appellants' contention, the acts complained of here—defective notice and improper selection of the arbitration panel—were not only performed

directly in connection with the CBOE's management of contractually agreed upon arbitration, but, we believe, were sufficiently associated with the adjudicative phase of the arbitration to justify immunity. Reducing the CBOE's immunity based on the arbitral deficiencies present here would merely serve to discourage its sponsorship of future arbitrations—a policy that is strongly encouraged by the Federal Arbitration Act. *See* 9 U.S.C. §§ 2, 3, 4; *see also Moses H. Cone Memorial Hosp.* v. *Mercury Construction Corp.*, 460 U.S. 1, 24 (1983) ("Section 2 [of the Federal Arbitration Act] is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary."). On the facts of this case, we are unwilling to undermine this policy by parsing the arbitration process. Accordingly, we conclude, as did the district court, that the CBOE is immune from liability in damages for its conduct in sponsoring the arbitration proceedings in question.

Because we base our decision solely on the doctrine of arbitral immunity, it is unnecessary to address appellants' claim of remedial non-exclusivity of the Federal Arbitration Act, 9 U.S.C. §§ 1-14.

CONCLUSION

As the CBOE is shielded from civil liability for the challenged acts under the doctrine of arbitral immunity, we affirm the judgment of the district court dismissing the Austerns' complaint.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

- - - - - - - - - - - - - - - - x

S. EZRA AUSTERN and ESTHER AUSTERN,

Plaintiffs,

89 Civ. 0462(MGC)

- against -

OPINION AND ORDER

THE CHICAGO BOARD OPTIONS EXCHANGE, INC.

Defendant.

- - - - - - - - - - - - - - - - - - x

APPEARANCES:

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By: Reid L. Ashinoff
Mark S. Pomerantz

CEDARBAUM, J.

S. Ezra Austern and Esther Austern sue the Chicago Board Options Exchange, Inc. ("CBOE"), for $608,000 in damages arising out of an arbitration award rendered by a CBOE-sponsored panel on October 24, 1986. CBOE has moved to dismiss the complaint, pursuant to Fed. R. Civ. P. 12(b) (6). For the reasons discussed below, the motion is granted.

BACKGROUND

For purposes of this motion, the complaint is accepted as true. The opinion of the Honorable Charles P. Kocoras, United States District Judge for the Northern District of Illinois, in Fried Trading Co. v. Austern, No. 86 C 8223 (N.D. Ill. Nov. 30, 1988), is a part of the complaint. Fed. R. Civ. P. 10(c). The Austerns are bound by the findings of fact made by the district court in that

opinion. See Wilder v. Thomas, 854 F.2d 605, 616 (2d Cir. 1988), cert. denied, 109 S. Ct. 1314 (1989).

At the time of the events in question and until November 1986, the Austerns were residents of Bnei Brak, Israel. On September 14, 1984, Fried Trading Company ("Fried") filed with CBOE a petition for arbitration, pursuant to a limited partnership agreement to which Mrs. Austern was a party. After the Austerns answered the petition, CBOE accepted the matter for arbitration. CBOE agreed that a panel of arbitrators would be chosen pursuant to CBOE guidelines, with a majority of the panel coming from outside of the securities industry. CBOE also agreed to attempt to accommodate the Austern's schedule with a convenient hearing date, in recognition of the great distance they would have to

travel to attend a hearing in Chicago.

In September of 1986, the Austerns withdrew their appearance, answer and counterclaim in the CBOE arbitration, after they learned that Fried was a differently configured partnership from the Fried Trading Company with which the Austerns had understood they would arbitrate. Nevertheless, on October 22 and 23, 1986 a panel of five arbitrators designated by CBOE conducted an arbitration hearing. None of the arbitrators was from outside the securities industry.

CBOE had attempted to provide the Austerns with notice of the hearing through the law firm of Sachnoff, Weaver and Rubenstein ("Sachnff"), which was representing the Austerns in state court. On October 9, 1986, CBOE sent notice to Sachnoff. That same day, however, Sachnoff withdrew as counsel for the

Austerns in state court. In addition, correspondence between the Austerns and CBOE dated September 26, 1986, suggests that the Austerns would be representing themselves before CBOE. Sachnoff acknowledged receipt of the notice on October 10, seven business days prior to the hearing date, and informed CBOE that while the firm no longer represented the Austerns, it would forward notice to them in Israel. Sachnoff indicated that the Austerns would receive the notice in Israel in four or five days. The Austerns did not receive any notice of the arbitration hearing from CBOE, and the hearing took place without their knowledge or presence. Judge Kocoras found that the Austerns were not provided adequate notice of the hearing as required by CBOE guidelines, which called for eight business days' notice of

hearing to all parties. The hearing dates were impracticable in any event because they coincided with the Jewish holiday of Sukkot, which the Austerns observe.

The arbitration panel issued an award in favor of Fried. On October 29, 1986, Fried commenced a proceeding in the United States District Court for the Northern District of Illinois to confirm the award. Judge Kocoras denied Fried's petition for confirmation because CBOE had not provided adequate notice of the hearing to the Austerns. Fried Trading Company v. Austern, No. 86 C 8223 (N.D. Ill. Nov. 30, 1988).

In this action, the Austerns seek to recover damages for mental anguish and the expense of defending against Fried's confirmation action. They claim that CBOE's negligent failure to give notice

of the arbitration proceeding caused these injuries. The Austerns also claim that CBOE violated their right to due process under the Fourteenth Amendment to the United States Constitution and Article I, Section 2 of the Illinois Constitution. CBOE contends that the complaint should be dismissed because the acts of CBOE are protected by the quasi-judicial immunity that protects arbitrators and their sponsoring organizations from personal liability, and also because the Federal Arbitration Act, 9 U.S.C. Secs. 1 et seq., provides the exclusive remedy for challenging arbitration awards. The Austerns argue that the conduct of which they complain falls outside the scope of arbitral immunity.

DISCUSSION

Courts have generally protected

arbitrators from suit for their conduct in arbitration proceedings. See U.A.W. v. Greyhound Lines, Inc., 701 F.2d 1181, 1185 (6th Cir. 1983); Corey v. New York Stock Exchange, 691 F.2d 1205, 1211 (6th Cir. 1982); Tamari v. Conrad, 552 F.2d 778, 780 (7th Cir. 1977); Cahn v. International Ladies' Garment Union, 311 F.2d 113, 114-115 (3d Cir. 1962) (per curiam); Calzarano v. Liebowitz, 550 F. Supp. 1389, 1390 (S.D.N.Y. 1982). This quasi-judicial immunity has been expanded to protect associations, boards and other organizations sponsoring and administering arbitrations. See Corey, 691 F.2d at 1211; Rubenstein v. Otterbourg, 78 Misc. 2d 376, 376, 357 N.Y.S.2d 62, 63-64. The Austerns contend that, since the acts of CBOE in this case were purely administrative in nature, and not a part of the decision-making process, CBOE is

not entitled to immunity from this suit. But assigning the proper category to the conduct at issue is not a semantic exercise. The determination of whether CBOE's acts in this case fall within the scope of quasi-judicial conduct requires an examination of the reasons for such protection.

There are two important policies that are promoted by according arbitrators immunity from suit. The first is the same policy as that underlying the doctrine of judicial immunity: the importance of protecting the integrity of the decision-making process from the fear of reprisals by dissatisfied litigants. See Greyhound Lines, 701 F.2d at 1186; Tamari, 552 F.2d at 781; Corey, 691 F.2d at 1209. Immunity is extended to those such as arbitrators who perform quasi-judicial functions because "[t]he

functional comparability of the arbitrators' decision-making process and judgments to those of judges . . . generates the same need for independent judgment, free from the threat of lawsuits. Immunity furthers this need." Corey, 691 F.2d at 1211. Secondly, "individuals . . . cannot be expected to volunteer to arbitrate disputes if they can be caught up in the struggle between the litigants and saddled with the burdens of defending a lawsuit." Tamari, 552 F. 2d at 781. In order to develop and maintain a pool of qualified persons willing to act as arbitrators, it is important to protect arbitrators against personal liability.

These policies underlying arbitral immunity support an expansive treatment of the conduct included within the scope of protection. The social cost of

precluding a small number of meritorious claims is outweighed by the burden that would be placed on arbitrators and their sponsors if they had to defend against frivolous suits.

The Austerns argue that the acts of which they complain -- mailing notice of the hearing, selecting five arbitrators from the securities industry, choosing a hearing date -- were not quasi-judicial but purely ministerial. The distinction, they argue, is that the acts themselves did not require the exercise of discretion and judgment. Thus, they liken these acts to the conduct of a CBOE porter in negligently leaving a puddle of soapy water in the hearing room.

The Austerns artificially divide the same function into two parts, one protected, the other beyond the scope of arbitral immunity, without reference to

the impact of the conduct on the arbitration proceeding. Accurate functional analysis is an appropriate method of distinguishing between protected arbitral conduct and other acts which, like the porter's mopping of the hearing room floor, are clearly unrelated to the arbitration proceeding because they do not have any effect on either the process or the award. Cf. Forrester v. White, 108 S. Ct. 538, 544 (1988) (In the judicial context, "immunity is justified and defined by the functions it protects and serves, not by the person to whom it attaches."). Notice of the proceeding selection of the arbitrators, and the choice of a hearing date are all integrally related to the process of arbitration and cannot logically be denied the same protection.

In support of their position, the

Austerns rely on a decision of a California state court. In Baar v. Tigerman, 140 Cal. App. 3d 979, 189 Cal. Rptr. 834 (1983), the court declined to grant quasi-judicial immunity to an arbitrator or his sponsor against a suit for breach of an express contract to render an award within a fixed period of time. The court distinguished the case from those in which quasi-judicial immunity has been granted to sponsors by deeming the sponsor's failure properly to oversee the arbitration process as an administrative and not a discretionary function. Id. at 987, 189 Cal. Rptr. at 840. Not only is Baar not binding on this court, but its reasoning is not persuasive. Furthermore, the protection of the Federal Arbitration Act was not available in that case.

In any event, because of the

corrective review provided by the Federal Arbitration Act, the Austerns cannot maintain this action. By defeating confirmation of the arbitration award, the Austerns have already obtained a remedy from another federal court for the wrongs of which they complain. With respect to claims within its purview, the Federal Arbitration Act provides the exclusive remedy for challenging conduct that taints an arbitration award. See Foster v. Turley, 808 F.2d 38, 41-42 (10th Cir. 1986); Corey, 691 F.2d at 1211-1213; Tamari v. Bache & Co. (Lebanon) S.A.L., 565 F.2d 1194, 1202 (7th Cir. 1977), cert. denied, 435 U.S. 905 (1978). The availability of direct review of the arbitration award also buttresses the appropriateness of applying the doctrine of arbitral immunity to preclude this collateral

proceeding.

Finally, the Austerns argue that immunity does not protect CBOE from federal and state constitutional claims. But "the protections of the Fourteenth Amendment do not extend to 'private conduct abridging individual rights.'" N.C.A.A. v. Tarkanian, 109 S.Ct. 454, 461 (1988) (quoting Burton v. Wilmington Parking Authority, 365 U.S. 715, 722 (1961). Only state action is subject to scrutiny under the Fourteenth Amendment's Due Process Clause. Tarkanian, 109 S.Ct. at 461; Jackson v. Metropolitan Edison Co., 419 U.S. 345, 349 (1974); Shelley v. Kraemer, 334 U.S. 1, 13 (1948). Although the Illinois due process clause is not expressly limited to state action, the Illinois Supreme Court has so interpreted it. USA I. Lehndorff Vermoegensverwaltung GmbH & Cie v. Cousins Club, Inc., 64 Ill.

2d 11, 20-21, 348 N.E.2d 831, 834-835 (1976). Since the conduct of CBOE did not in any way constitute state action, the Austerns do not state a claim for violation of their constitutional rights to due process.

Accordingly, the Austerns' complaint is dismissed for failure to state a claim upon which relief can be granted.

SO ORDERED.

Dated: New York, New York
July 31, 1989

s/MIRIAM GOLDMAN CEDARBAUM
United States District Judge

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN THE MATTER OF THE ARBITRATION BETWEEN:	)	
FRIED TRADING COMPANY, Petitioner,	)	No. 86 C 8223
and	)	
EZRA AUSTERN and ESTHER AUSTERN Respondents.	)	

MEMORANDUM OPINION

CHARLES P. KOCORAS, District Judge:

The issue to be decided by the Court is whether the Chicago Board Options Exchange ("CBOE") has jurisdiction to resolve the pending dispute between Fried Trading Company ("FTC") and Esther and Ezra Austern. For the following reasons, this Court finds that the CBOE has jurisdiction to arbitrate the parties' dispute.

FACTS

On September 1, 1983 a limited

partnership was formed known as Fried Trading Company ("FTC") for the purpose of trading option contracts. Esther Austern was a limited partner and her husband Ezra Austern was a consultant for the partnership who recommended trades. The Limited Partnership Agreement upon which the above partnership was based contained an arbitration clause which required the parties to submit disputes to binding arbitration according to the Rules of the CBOE.

In February of 1984, a dispute arose between the parties arising from Ezra and Esther Austerns' option trading which resulted in a substantial deficit balance in the Austerns' account. Because the Austerns refused to pay the deficit, FTC submitted the matter to binding arbitration before the CBOE, pursuant to the arbitration clause in the Limited

Partnership Agreement. When the Austerns attempted to avoid CBOE arbitration, FTC instituted a proceeding before a religious tribunal in Israel, the Bais Din, to compel the Austerns to arbitrate in Chicago before the CBOE. Under the auspices of the Bais Din, the parties came to an agreement under which the Austerns agreed to arbitrate before the CBOE. The agreement, signed by the Austerns and Michael Koss on behalf of FTC, states:

> If FTC institutes arbitration proceedings against S. Ezra Austern or Esther Austern in Chicago in accordance with rules of CBOE, undersigned or their attorney (in fact or law) will undertake in good faith to appear therein.
>
> * * * *
>
> If Fried Trading Co. commences proceedings in Chicago at CBOE, it undertakes in good faith to prosecute same without delay so as to minimize expense of Austern in terms of time and money.
>
> Any question as to fault or

> good faith or delay of either party shall be decided by this Bais Din.

Pursuant to this agreement, on September 14, 1984, the dispute was returned to the CBOE for arbitration. The Austerns appeared, answered, counterclaimed and participated in the arbitration proceedings by filing discovery. Nevertheless, by letter dated February 6, 1985, the Austerns objected to the CBOE's jurisdiction and asked permission to withdraw their appearance allegedly because they discovered that FTC was not the same limited partnership that had been formed by the Septemer 1, 1983 partnership agreement. By decision of August 16, 1985, however, the CBOE determined that it did have jurisdiction to hear the dispute.

Thereafter, an evidentiary hearing was conducted by the CBOE arbitrators on

October 22 and 23, 1986 at which the Austerns failed to attend. On October 24, 1986, the arbitrators entered an award against the Austerns.

On November 30, 1988 this Court affirmed the report and recommendation of Magistrate Balog in denying confirmation of the CBOE award due to a deficiency in the notice of the hearing to the Austerns.

The sole issue before this court is whether jurisdiction to resolve the underlying dispute between the parties lies with the CBOE.

DISCUSSION

Jurisdiction to arbitrate a dispute is derived solely from the parties' agreement to arbitrate. An agreement to arbitrate may be express or implied from the conduct of the parties. Both the Federal Arbitration Act and the Illinois

Courts favor arbitration as a method of settling disputes.

The Austerns maintain that they are not required to arbitrate any disputes with the petitioner for two reasons. First, the Austerns argue that FTC, the Limited Partnership, is not the same entity as the petitioner bringing this claim. The Austerns contend that the FTC Limited Partnership was dissolved prior to the institution of the CBOE claim and a new entity, the FTC General Partnership, was formed when it added two new general partners and eliminated a prior general partner and all the limited partners. The Austerns assert that they have no agreement to arbitrate with this new entity, and thus, this action should proceed before this Court. Second, the Austerns claim that any agreement to arbitrate is governed by the Bais Din

Agreement, which allegedly provides that all disputes should be resolved by the Bais Din.

FTC argues, however, that it is the same entity with whom Esther Austern signed the Limited Partnership Agreement and with whom the Austerns executed the Bais Din Agreement. FTC contends that from its inception in 1983 to date, it has conducted all of its business, without interruption, as Fried Trading Co., a Limited Partnership and that it is recognized as such by all its brokers, bankers and merchants. FTC further maintains that based on the Bais Din Agreement and the Austerns' participation in the proceedings before the CBOE, both Esther and Ezra Austern agreed to submit to binding arbitration before the CBOE.

This Court finds that the underlying dispute in this case must be settled by

the CBOE. First, we believe that the petitioner is the same entity with whom Esther Austern executed the Limited Partnership Agreement and with whom the Austerns entered into the Bais Din Agreement. According to Section 51 of the Uniform Limited Partnership Act, "additional limited partners may be admitted upon filing an amendment to the original certificate. . . ." Section 52 of the Act provides that "without the written consent or ratification of the specific act by all the limited partners, . . . the general partners have no authority to . . . (e) Admit a person as a general partner. . . ." Thus, it appears from these sections that any attempt made by FTC to add new limited or general partners without filing an amendment to the original agreement or obtaining the consent of Esther Austern,

which she vigorously asserts she did not give, was merely unsuccessful. The Uniform Limited Partnership Act does not provide that such an attempt to add new partners dissolves the original partnership or creates a new partnership. Accordingly, the Austerns' argument that the addition of these new partners without Esther Austern's consent dissolved the old partnership and created a new one must fail.

In addition, the Court believes that the execution of the Bais Din Agreement and the parties' conduct following such execution clearly indicates that both Ezra and Esther Austern agreed to have their disputes with FTC submitted to binding arbitration before the CBOE. The Bais Din Agreement states, "If FTC institutes arbitration proceedings against S. Ezra Austern or Esther Austern

in Chicago in accordance with rules of CBOE, undersigned or their attorney (in fact or law) will undertake in good faith to appear therein." Moreover, in accordance with this agreement, FTC instituted arbitration proceedings, and the Austerns appeared, responded, counterclaimed, and entered into discovery. In light of these facts, the Court cannot possibly conclude that the Austerns did not intend to be bound by the CBOE's decisions.

Based on the foregoing discussion the Court finds that the action pending before this Court must proceed before the CBOE and accordingly, we lift the preliminary injunction currently in force.

/s_____
Charles P. Kocoras
United States District Judge

Dated: May 19 1989

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

[Filed APR 27 1990]

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, in the City of New York, on the twenty-seventh day of April, one thousand nine hundred and ninety.

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S. EZRA AUSTERN AND ESTHER AUSTERN,
Plaintiffs-Appellants,

- against - Docket No. 89-7792

THE CHICAGO BOARD OPTIONS EXCHANGE, INC.,
Defendant-Appellee.
- - - - - - - - - - - - - - - - x

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by Plaintiffs-Appellants S. EZRA AUSTERN and ESTHER AUSTERN.

Upon consideration by the panel that heard the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for hearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

s/ ELAINE B. GOLDSMITH
Clerk

UNITED STATES DISTRICT COURT FOR
THE SOUTHERN DISTRICT OF NEW YORK

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S. EZRA AUSTERN and ESTHER AUSTERN

Plaintiffs, CIVIL ACTION FILE NO. 89 CIV.0462

- against -

THE CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED

AMENDED COMPLAINT

Defendant.

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Plaintiffs, as and for their amended complaint herein, by their attorney, S. EZRA AUSTERN, allege:

AS AND FOR A FIRST AND SEPARATE CAUSE OF ACTION

1. Plaintiffs are residents and citizens of the State of New York.

2. At all times hereinafter mentioned prior to November, 1986, Plaintiffs were residents of Bnei Brak, Israel.

3. On information and belief,

defendant, THE CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED (CBOE) is a Delaware corporation having an office and principal place of business in the State of Illinois and having an office in the County of New York, State of New York.

4. On information and belief, CBOE is licensed to do business and is doing business in the County of New York, State of New York, located within the judicial district known as the Southern District of New York.

5. The amount in controversy herein exceeds the sum of $10,000.00 exclusive of interest and costs.

6. On or about September 14, 1984 a petition for arbitration was filed with the CBOE by a partnership known as FRIED TRADING COMPANY (FRIED), in which plaintiffs (designated therein as EZRA AUSTERN and ESTHER AUSTERN)

were named as respondents.

7. On or about August 16, 1985, the CBOE made a determination as follows:

a) That the said matter was accepted for arbitration under Chapter XVIII of The CBOE Rules - that is, the rules pertaining to CBOE arbitration;

b) that a panel of arbitrators would be selected pursuant to Rule 18.10 of such rules, and that a majority of such panel would not be from the securities industry;

c) that the CBOE would attempt to accommodate the schedule of the plaintiffs (respondents therein) with a convenient hearing date or dates "due to the great distance Respondents will have to travel to attend a hearing..."

8. Thereafter and prior to October 22, 1986, the CBOE designated and selected five arbitrators to act as a panel of

arbitrators in the said matter, consisting of JOHN J. FREEMAN, MARSHALL V. KEARNEY, JAMES F. MCDONNELL, III, JOHN P. REILLY and FRED TEICHERT, all of whom were CBOE market makers and from the securities industry.

9. Pursuant to such designation and selection, and purporting to act in accordance with the provisions contained in such CBOE rules pertaining to arbitration, the CBOE on October 22nd and 23rd, 1986 caused an arbitration hearing to be held before the said panel of arbitrators in the said matter.

10. Said hearing was the initial hearing and the only hearing held in the said arbitration matter.

11. On October 24, 1986, said arbitrators made and issued an "award", a copy of which is set forth in Exhibit A annexed hereto and made a part hereof.

12. Said award provided among other things that plaintiff ESTHER AUSTERN pay to the said FRIED the sum of $152,959.88 plus interest and $4,000.00 for legal fees, and that Plaintiff S. EZRA AUSTERN pay to the said FRIED the sum of $4,000.00 for legal fees.

13. The CBOE failed and neglected to give to plaintiffs (respondents in the said arbitration) any notice of such hearing held on October 22nd and 23rd, 1986; and same was held and conducted without the knowledge or presence of plaintiffs or their representatives.

14. Rule 18.16 of the CBOE rules pertaining to arbitration provides as follows:

"Notice of the time and place for the initial hearing shall be given at least eight (8) business days prior to the date fixed for the hearing by personal service, registered or certified mail to each of the parties..."

15. Said failure and neglect to give Plaintiffs such notice of hearing were in violation of such rule.

16. Thereafter, on or about October 29th, 1986, said FRIED as petitioner commenced a proceeding in the United States District Court for the Northern District of Illinois, Eastern Division, against Plaintiffs, S. EZRA AUSTERN AND ESTHER AUSTERN to confirm the said arbitration award, bearing file number 86C8223 and entitled: IN THE MATTER OF THE ARBITRATION BETWEEN: FRIED TRADING COMPANY, Petitioner, and EZRA AUSTERN and ESTHER AUSTERN, Respondents.

17. On or about August 3rd, 1988 the HONORABLE JAMES T. BALOG, United States Magistrate, in a Report and Recommendation to the HONORABLE CHARLES B. KOCORAS, Judge of the said United States District Court, recommended that

the said petition to confirm the said arbitration award be denied. A copy of such Report and Recommendation is annexed hereto as Exhibit B and made a part hereof.

18. On or about October 3rd, 1988, the said HONORABLE JAMES T. BALOG, United States Magistrate, denied FRIED's motion for reconsideration.

19. On or about October 20th, 1988, FRIED filed with the said United States District court for the Northern District of Illinois, objection to the said Report and Recommendation of MAGISTRATE BALOG.

20. On or about November 30th, 1988, the said Court affirmed the said Report and Recommendation of MAGISTRATE BALOG, holding that the alleged CBOE notice of hearing to respondents had been inadequate and had not satisfied the

requirements of said Rule 18.16. A copy of the memorandum, opinion and decision of JUDGE KOCORAS is annexed hereto as Exhibit C and made a part hereof.

21. The said proceeding brought by FRIED has been pending and active in the said United States District Court for the Northern District of Illinois for the past two and one quarter years.

22. In connection with the defense of such proceeding, Plaintiff, S. EZRA AUSTERN, as attorney for plaintiffs (respondents therein) has expended to date a sum of time in excess of 500 hours in the performance of professional legal services necessarily incurred, including research, drafting, conferences, appearances, examinations and other legal services.

23. The fair and reasonable value of such legal services is the sum of $200 per hour, or a total in excess of $100,000.00.

24. Further in connection with the defense of the said proceeding, Plaintiffs have necessarily expended the sum of $2,000.00 for the services of local counsel in Chicago, Illinois; $5,000.00 on expenses of travel to and from Chicago, and $1,500.00 on miscellaneous disbursements necessarily incurred.

25. The defense of the said proceeding and each and every item of expense in connection therewith, as hereinabove set forth, were the direct and proximate result and consequence of the failure and neglect of the CBOE to give respondents notice of the said arbitration hearing.

26. Such failure and neglect to give plaintiffs notice of the said arbitration hearing amounted to callous and reckless misconduct, negligence, carelessness and wanton disregard of common decency and fair play.

27. As a result of such failure and neglect to give plaintiffs notice of the said arbitration hearing, plaintiffs have been for more than two and one quarter years, unduly harrassed, tormented, annoyed, distressed, pained and afflicted; and have suffered mental anguish, vexation, distress, discomfort, pain and suffering.

AS AND FOR A SECOND AND SEPARATE CAUSE OF ACTION

28. Plaintiffs repeat and reallege each and every allegation contained in paragraphs numbered 1 through 27 set forth above with the

same force and effect as if here set forth at length.

29. Said failure and neglect to give plaintiffs notice of said arbitration hearing was in violation of the provisions contained in the 14th amendment to the Constitution of the United States entitling Plaintiffs to due process of law. It was further in violation of the provisions contained in Article I, Section 2 of the Constitution of 1970 of the State of Illinois, which provides as follows: No person shall be deprived of life, liberty or property without due process of law nor be denied the equal protection of the laws.

AS AND FOR A THIRD AND SEPARATE CAUSE OF ACTION

30. Plaintiffs repeat and reallege each and every allegation contained in paragraphs numbered 1

through 27 set forth above with the same force and effect as if here set forth at length.

31. Said failure and neglect to give plaintiffs notice of the arbitration hearing was further in violation of Rule 18.16 of the aforementioned CBOE Rules Pertaining to Arbitration, in that less than eight business days notice was given.

32. Such failure and neglect was wrongful and improper, and was bound to and did cause plaintiffs grievous and serious harm, injury and damages.

AS AND FOR A FOURTH AND SEPARATE CAUSE OF ACTION

33. Plaintiffs repeat and reallege each and every allegation contained in paragraphs numbered 1 through 27 set forth above with the same force and effect as if here set forth at length.

34. Rule 18.10 of Chapter XVIII (CBOE Rules Pertaining to Arbitration) provides: "(2) In all arbitration matters involving public customers where the amount in controversy is $100,000 or more, the Director of Arbitration shall appoint an arbitration panel which shall consist of five (5) arbitrators, at least a majority of whom shall not be from the securities industry..."

35. The aforementioned designation and selection of a panel of arbitrators, all of whom were CBOE market makers and from the securities industry, were wrongful and improper in that:

a) same violated the provisions contained in the said Rule 18.10, and

b) same violated the aforementioned determination of the CBOE made on or about August 16, 1985, to wit, that a majority of the arbitrators designated and selected would not be from the securities industry.

36. Same was bound to and did cause

plaintiffs grievous and serious harm, injury and damages.

AS AND FOR A FIFTH AND SEPARATE CAUSE OF ACTION

37. Plaintiffs repeat and reallege each and every allegation contained in paragraphs numbered 1 through 27 set forth above with the same force and effect as if here set forth at length.

38. The CBOE made no attempt whatsoever to accommodate the schedule of the said plaintiffs (respondents therein) with a convenient hearing date or dates due to the great distance - 7,000 miles - plaintiffs had to travel from Israel to attend an arbitration hearing in Chicago.

39. In scheduling October 22nd and 23rd, 1986 as arbitration dates, the CBOE knew or should have known that

such dates coincided with the Jewish religious festival of Sookos; that Plaintiffs were observant Jews who scrupulously observed all Jewish religious days, and that the scheduling of a hearing on such days was neither convenient nor practicable nor feasible for Plaintiffs; and the CBOE in any event made no attempt whatsoever to accommodate the schedule of plaintiffs with respect to such religious festival; and never provided plaintiffs with an opportunity to adjourn same.

40. Such failure to attempt to accommodate the schedule of Plaintiffs was in violation of the CBOE's own determination made and issued on or about August 16th 1985.

41. Same was wrongful and improper, and was bound to and did cause plaintiffs grievous and serious harm, injury and

damages.

AS AND FOR A SIXTH AND SEPARATE CAUSE OF ACTION

42. Plaintiffs repeat and reallege each and every allegation contained in paragraphs numbered 1 through 27 set forth above with the same force and effect as if here set forth at length.

43. The said petitioner for CBOE arbitration, FRIED, purported in its petition to be a limited partnership that had been formed as of September 1, 1983 by virtue of a limited partnership agreement entered into by and among TED FRIED, RODNEY HUBBS and MARIA ZAMBUTO as general partners and JORGE GOTTLIEB and ESTHER AUSTERN as limited partners. On or about September 26, 1986, upon learning that such claimant in the CBOE arbitration was in fact and in law an entity separate,

distinct and different from the said limited partnership, although bearing the same guise and name, plaintiffs withdrew and cancelled the appearance, answer and counterclaim theretofore made, since they had never agreed to submit to arbitration any dispute with such separate, distinct and different entity.

44. Notwithstanding the receipt by the CBOE and its Director of Arbitration of such withdrawal and cancellation and while knowing that a motion was then pending in the Circuit Court of Cook County, Illinois to enjoin arbitration by reason of the foregoing, and that the CBOE arbitrability was sub judice, the CBOE nonetheless scheduled the said hearing for October 22nd and October 23rd, 1986.

45. Such conduct was wrongful and improper, and bound to and did cause

plaintiffs serious and grievous harm, injury and damages.

AS AND FOR A SEVENTH AND SEPARATE CAUSE OF ACTION

46. Plaintiffs repeat and reallege each and every allegation contained in paragraphs numbered 1 through 27 set forth above with the same force and effect as if here set forth at length.

47. No submission agreement whereby plaintiffs ever agreed to submit any dispute with FRIED to binding CBOE arbitration was ever executed by Plaintiffs.

48. In the absence of such submission agreement, it was wrongful and improper for the CBOE to schedule an arbitration hearing in the said matter, and same was bound to and did cause plaintiffs serious and grievous harm,

injury and damages.

AS AND FOR AN EIGHTH AND SEPARATE CAUSE OF ACTION

49. Plaintiffs repeat and reallege each and every allegation contained in paragraphs numbered 1 through 27 set forth above with the same force and effect as if here set forth at length.

50. Rule 18.11 of the CBOE Rules Pertaining to Arbitration provides: "The Director of Arbitration shall inform the parties of the names and business affiliations of the arbitrators at least eight (8) business days prior to the date fixed for the initial hearing session."

51. Rule 18.12 of the CBOE Rules Pertaining to Arbitration provides: "In an arbitration proceeding being heard by a panel consisting of more than one (1) arbitrator, each party shall have the right to one (1) peremptory challenge.

52. Plaintiffs were never provided any opportunity to challenge any

arbitrator designated and selected, inasmuch as they never received notice of the names and business affiliations of such arbitrators in accordance with the provisions hereinabove set forth.

53. Such failure and neglect were in violation of Rules 18.11 and 18.12 of the said CBOE Rules Pertaining to Arbitration, were wrongful and improper, and were bound to and did cause plaintiffs grievous and serious harm, injury and damages.

AS AND FOR A NINTH AND SEPARATE CAUSE OF ACTION

54. On or about October 11, 1986 the CBOE received a letter from SACHNOFF, WEAVER AND RUBENSTEIN, LTD. dated October 10, 1986 which advised the CBOE that such firm did not represent Plaintiffs.

55. On information and belief, notwithstanding such receipt eleven days,

or thereabout, prior to the scheduled date of arbitration fixed by the CBOE, the CBOE made no effort whatsoever to give notice to plaintiffs of the impending hearing; and while knowing or while it should have known that it was then physically impossible to give to plaintiffs notice of such October 22nd and 23rd hearing in accordance with the requirements of the aforementioned Rule 18.16 of the CBOE Rules Pertaining to Arbitration, it took no steps whatsoever to advise plaintiffs thereof or otherwise to cause such hearing to be adjourned.

56. Such conduct was wrongful and improper, and bound to and did cause plaintiffs grievous and serious harm, injury and damages.

57. By reason of all of the foregoing, Plaintiffs have been damaged

as follows:

For mental anguish, distress, discomfort, pain and suffering	$500,000.00
For attorney's fees and time necessarily incurred in the defense of proceeding in the United States District Court to confirm said award, and the fair value of services as attorney performed in connection therewith	100,000.00
For the cost and expense of local counsel in Chicago, Illinois necessarily incurred	2,000.00
For expenses of travel to and from Chicago	5,000.00
For other miscellaneous disbursements necessarily incurred	1,500.00
	$608,500.00

WHEREFORE, Plaintiffs demand judgment against defendant in the sum of $608,500 together with costs and disbursements.

Dated: New York, N.Y.
May 9, 1989

s/ _____
S. EZRA AUSTERN
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